



Orkney Islands

Annual Audit Report to the Controller of Audit and Council

24 January 2024

Key contacts

Your key contacts in connection with this report are:

Michael Wilkie

Director

Tel: 07795370106

Michael.Wilkie@kpmg.co.uk

Matthew Moore

Senior Manager

Tel: 07468 369807

Matthew.moore@kpmg.co.uk

Monazzah Samad

Assistant Manager

Tel: 07468 750465

Monazzah.samad@kpmg.co.uk

Contents	Page
Introduction	3
Audit conclusions	5
Materiality	6
Our audit findings	7
Significant risks and other areas of focus	9
Key accounting estimates	15
Group Involvement	17
Other significant matters	18
Wider Scope and Best Value	19
Appendices	40

Introduction

Purpose of this report

The Accounts Commission has appointed KPMG LLP as auditor of Orkney Islands Council (the Council) under part VII of the Local Government (Scotland) Act 1973 (“the Act”). The period of appointment is 2022-23 to 2026-27, inclusive.

Our annual audit report is designed to summarise our opinions and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at the Council and the Controller of Audit. The scope and nature of our audit are set out in our audit strategy document which was presented to the Audit Committee on 29 June 2023.

Audit Scotland’s Code of Audit Practice (“the Code”) sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements but also consideration of wider scope areas. The reports incorporates both aspects of the Code.

Accountable officer responsibilities

The Code sets out Orkney Islands Council’s responsibilities in respect of:

- corporate governance;
- financial statements and related reports;
- standards of conduct for prevention and detection of fraud and error
- financial position; and
- Best Value.

Auditor responsibilities

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK) issued by the Financial Reporting Council and the Code.

How we have delivered audit quality

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion. We consider risks to the quality of our audit in our engagement risk assessment and planning discussions.

We define ‘audit quality’ as being the outcome when audits are:

- **Executed consistently**, in line with the requirements and intent of **applicable professional standards** within a strong **system of quality controls** and
- All of our related activities are undertaken in an environment of the utmost level of **objectivity, independence, ethics** and **integrity**.

External auditors do not act as a substitute for the Council’s own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

Introduction

Limitations on work performed

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland’s Code of Audit Practice (“the auditing Code”).

This report is for the benefit of Orkney Islands Council and is made available to Audit Scotland and the Controller of Audit (together “the Beneficiaries”). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

Nothing in this report constitutes an opinion on a valuation or legal advice. We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scoping and purpose section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary’s Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.

Status of our audit

Our audit is complete.

Audit Conclusions

Audit opinion

Following approval of the annual accounts by the Council on 29 November 2023, we issued an unqualified opinion on the truth and fairness of the state of the Council's affairs as at 31 March 2023, and of the surplus for the year then ended. There are no matters identified on which we are required to report by exception.

Financial reporting framework, legislation and other reporting requirements

The Council is required to prepare its annual accounts in accordance with International Financial Reporting Standards, as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2022-23 ("the CIPFA Code"), and in accordance with the Local Authority Accounts (Scotland) Regulations 2014. Our audit confirmed that the annual accounts have been prepared in accordance with the CIPFA Code and relevant legislation.

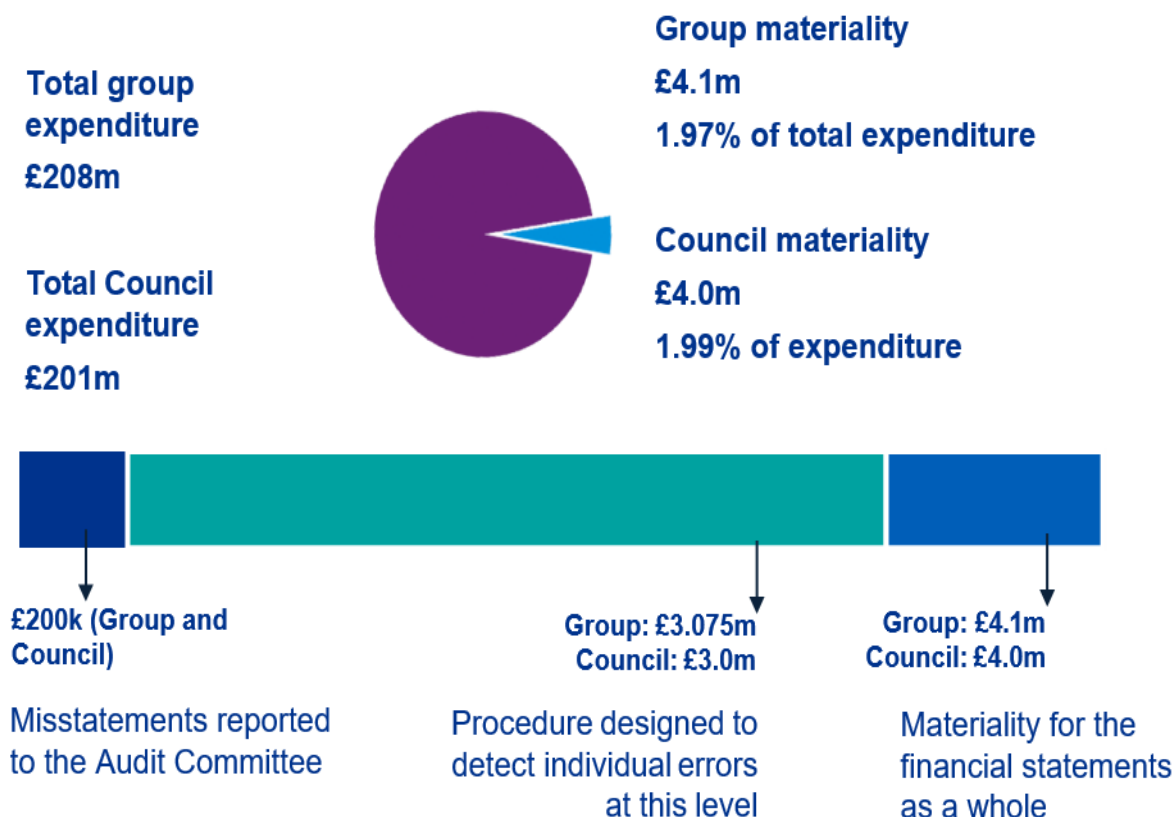
Statutory reports

We have not identified any circumstances to notify the Controller of Audit that indicate a statutory report may be required.

Other communications

We did not encounter any significant difficulties during the audit. There were no other significant matters arising from the audit that were discussed, or subject to correspondence with management that have not been included within this report. There are no other matters arising from the audit, that, in our professional judgement, are significant to the oversight of the financial reporting process.

Materiality - Group and Council



Our materiality levels

We determined materiality for the consolidated financial statements at a level which could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. We used a benchmark of gross expenditure which we consider to be appropriate as it reflects the scale of the Group/Council's services and we consider this most clearly reflects the interests of users of the Group/Council's accounts. To respond to aggregation risk from individually immaterial misstatements, we design our procedures to detect misstatements at a lower level of performance materiality of £3.075m (Council: £3.0m). We also adjust this level further downwards for items that may be of specific interest to users for qualitative reasons.

Group materiality vs other metrics	
2022/23	
Total assets	0.53%
Total Revenues	2.3%

The above percentages reflect our Group materiality level as a proportion of other key account balances (Total Assets and Total Revenues) for 2022/23

Our audit findings

Significant audit risks	Risk Change since planning	Findings (Pages 9-14)
1 Retirement benefit obligations *	No change	We have identified that there was not a Management Review Control (MRC) to address the significant audit risk. An audit difference was identified, which has been adjusted by management in respect of Actual rate of return on assets as against the estimated rate included in the draft statements.
2 Valuation of Land & Buildings *	No change	We have identified that there was not a Management Review Control (MRC) to address the significant audit risk. An audit difference has been identified, which has been adjusted by management in respect of the valuation of the Council head office
3 Fraud risk from expenditure recognition (cut-off of expenditure)	Refined to risk around cut-off of expenditure at year end	We did not identify any issues in relation to fraud risk from expenditure recognition.
4 Management override of controls	No change	We have not identified any instances of management override of controls.
Other audit areas	Risk Change since planning	Findings (pages 44 & 50)
5 Valuation of Provision of de-commissioning Flotta Oil Terminal	No change	We have identified an error in the calculation of the provision which has been corrected and recommend a control be implemented as part of the annual closedown work programme.
Key accounting estimates	Judgement	Findings (Pages 15-16)
Retirement benefit obligations (LGPS)	Neutral	Overall we considered the assumptions underpinning the valuation of the LGPS obligation to be neutral / balanced.
Valuation of Land & Buildings	Optimistic	We have reviewed the data, assumptions and methodology involved in managements' valuation of land and buildings. We have assessed that certain assumptions included in the valuation were optimistic, while not having a material effect on the overall valuation.

Our audit findings

Uncorrected Audit Misstatements

Page 54

Two audit misstatements to report.

Corrected Audit Misstatements

Pages 50-53

There were six corrected audit misstatements greater than our trivial threshold, resulting in an overall charge to the CIES of £5,010m.

Number of Control Recommendations

Pages 43-49

Priority one control recommendations	0
Other control recommendations	3
Wider Scope and Best Value recommendations (including one priority one)	7
Prior year control recommendations outstanding	1

Wider Scope and Best Value (Pages 19-39)

Under the Code of Audit Practice we are required to consider the areas defined in the Code of Audit Practice as wider-scope audit. We are required to provide clear judgements and conclusions on the effectiveness and appropriateness of the arrangements in place based on the work that we have done. Where significant risks are identified we will make recommendations for improvement. To consider how effectively the Council demonstrates Best Value in its delivery of services we consider the audit findings across the four audit dimensions. The Best Value section includes our conclusions relating to the audit dimension of Value for Money which contribute to the delivery of Best Value.

Preparation of the financial statements

The Council planned to approve the financial statements by 30 September 2023. They will be ultimately approved on 29 November 2023. They were subsequently published after the statutory date of 31 October 2023. The delay supported the quality of the final financial statements and associated audit work. As is common in a first year audit, we spent time understanding and challenging existing accounting practices and judgements in a number of areas. The finance team is relatively small and we want to acknowledge the support of management in conducting the external audit. In general, high quality supporting information was provided in response to audit queries. There is scope for some improvement in the information provided in respect of valuation of land and buildings. This includes underlying data used by, instructions issued and process

conducted by the Council's valuer.

Audit Risks and our audit approach

1- Retirement benefit Obligations

Significant Audit risk

Risk: An inappropriate amount is estimated and recorded for the defined benefit obligation

The valuation of the Local Government Pension Scheme (Orkney Pension Fund) relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Council's overall valuation.

There are financial assumptions and demographic assumptions used in the calculation of the Council's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Council's employees, and should be based on appropriate data. The basis of the assumptions should be derived on a consistent basis year to year, or updated to reflect any changes.

There is a risk that the assumptions and methodology used in the valuation of the Council's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.

Pension Funds in surplus pose an additional risk to Councils, as the entity will need to assess the level of surplus that it can recognise. This will need to be assessed each year, and the conclusion can change from one year to the next based on facts and circumstances for each participation.

Our response

We performed the following procedures designed to specifically address the significant risk associated with the valuation:

Control design:

- We evaluated the design and implementation of controls in place for management to review the LGPS valuation and the appropriateness of assumptions used.

Assessing the actuarial expert's credentials:

- We evaluated the competency and objectivity of the Scheme actuaries, Hymans Robertson, to confirm their qualifications and the basis for their calculations.

Input assessment:

- We reviewed the input from the Council into the calculation of the LGPS valuation; and
- We agreed the data provided by the audited entity to the Scheme Administrator for use within the calculation of the scheme valuation.

Audit Risks and our audit approach

1- Retirement benefit Obligations (continued)

Assessing methodology and benchmarking assumptions:

- We challenged, with the support of our own actuarial specialists, the key assumptions applied, being the discount rate, inflation rate, salary increases and mortality/life expectancy against externally derived data where appropriate; and
- We confirmed that the accounting treatment and entries applied by the Authority are in line with the requirements of the Code.

Assessing transparency:

- Disclosures: We considered the adequacy of the disclosures concerning the key judgements and degree of estimation involved in arriving at the valuation, in addition to disclosures regarding the sensitivity of the Authority's defined benefit obligation to these assumptions.

Assessing the recognised Surplus:

- We considered the level of surplus that the Council has recognised and ensured that the asset recognised met the requirements of the CIPFA code for Local Authority Accounting in 2022-23.

Our findings

Our work is now complete in respect of this significant risk. Our actuarial specialists have evaluated the assumptions applied in measuring the defined benefit liabilities and have found these to be balanced, while remaining within actuaries' acceptable range. More detail is available on Page 16.

In assessing the Net pension Asset that has been recognised in the financial statements one material misstatement was identified between the actual rate of return on assets achieved and the value the Actuary estimated in their report. This misstatement has been corrected see adjusted misstatement 3 Page 50.

Auditing Standards requires where we have identified a significant audit risk, for management to have a review control in place (MRC) to respond to the risk. The threshold set for an effective Management Review Control is a high one, with various criteria that must be met including creating an independent expectation around amounts estimated. While we acknowledge that putting such a control in place would be impractical for a Council of your size, under Audit Standards we communicate to you that we have not identified such a MRC that is designed and implemented in such a way to provide the level of precision, response, investigation, and follow up needed by the Auditing Standards. **It is recommended.**

Audit Risks and our audit approach

2- Valuation of land and buildings

Significant Audit risk

Risk: The carrying amount of revalued Land & Buildings differs materially from the fair value

The value of the Council's Other Land and Buildings at 31 March 2022 was £306.7m, and Investment Property was £20.6m.

The Code requires that Land and Buildings and Investment Properties are subject to revaluation and their year end carrying value should reflect the fair value at that date.

Any asset valuation carries with it risks of estimation uncertainty. The size of the land and buildings balance relative to our expected materiality means that the risk of a material difference between carrying value and fair value is increased.

The Council is planning to commission a full revaluation of its land and buildings and Investment Properties, excluding infrastructure assets.

Our response

We performed the following procedures designed to specifically address the significant risk associated with the valuation:

Control design:

- We evaluated the design and implementation of controls in place for management to review the valuation and the appropriateness of assumptions used.

Assessing the valuer's credentials:

- We critically assessed the independence, objectivity and expertise of Orkney and Shetland Joint Valuation Board, the valuers used in developing the valuation of the Council's properties at 31 March 2023; and
- We inspected the instructions issued to the valuers for the valuation of land and buildings to verify they are appropriate to produce a valuation consistent with the requirements of the Code.

Input assessment:

- We compared the accuracy of the data provided to the valuers for the development of the valuation to underlying information, such as floor plans, and to previous valuations, challenging management where variances were identified.

Assessing methodology and benchmarking assumptions:

- We challenged the appropriateness of the valuation of land and buildings; including any material movements from the previous valuation. We challenged key assumptions within the valuation, including the use of relevant indices and assumptions around physical and functional obsolescence;

Audit Risks and our audit approach

2- Valuation of land buildings (continued)

- We performed inquiries of the valuers in order to verify the methodology that was used in preparing the valuation and whether it was consistent with the requirements of the Royal Institute of Chartered Surveyors (RICS) Red Book and the Code; and
- We agreed the calculations performed of the movements in value of land and buildings and verified that these had been accurately accounted for in line with the requirements of the Code.

Assessing transparency:

- Disclosures: We considered the adequacy of the disclosures concerning the key judgements and degree of estimation involved in arriving at the valuation.

Our findings

We have reviewed the data, assumptions and methodology involved in management's valuation of land and buildings and confirmed these were appropriate and consistent with the requirements of the Code. As outlined on Page 15,

We have identified one material misstatement due to the valuation basis for the main Kirkwall Council Office, this was initially valued at Market Value, however following challenge of reliability of the market value it was agreed that there is not a reliable market value for office accommodation of this size on the Orkney Islands and as required by the Code, where no reliable market exists the valuation should default to depreciated market value. This value led to a material misstatement in the carrying value of the main Kirkwall Council office – Corrected Misstatement number 2 page 50.

We have identified the methodology for providing an estimation of the obsolescence of replacement costs to reflect the age and condition of the building was based on a set matrix of obsolescence rates. On comparison with other recognised methods such as straight line obsolescence the rates used by the Council value were optimistic.

Auditing Standards requires where we have identified a significant audit risk, for management to have a review control in place (MRC) to respond to the risk. The threshold set for an effective Management Review Control is a high one, with various criteria that must be met including creating an independent expectation around amounts estimated. While we acknowledge that putting such a control in place would be impractical for a Council of your size, under Audit Standards we communicate to you that we have not identified such a MRC that is designed and implemented in such a way to provide the level of precision, response, investigation, and follow up needed by the Auditing Standards. **It is recommended.**

Audit Risks and our audit approach

3- Fraud risk from expenditure recognition – cut off of expenditure

Significant Audit risk

Risk: Liabilities and related expenses for purchases of goods or services are recorded in the incorrect period

Under ISA 240 there is a presumed risk that income may be misstated due to improper recognition of income. This requirement is modified by Practice Note 10, issued by the FRC, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

In our audit plan reported to you in June 2023, we outlined that we intended to rebut the presumed risk of fraudulent revenue recognition, as we considered that there are limited incentives and opportunities to manipulate the way income is recognised in a material way. We continue to rebut this presumed risk. We also reported that we had not at the planning stage of our audit rebutted the risk around expenditure recognition, and noted that this was most likely to occur through recognition of expenditure in the incorrect period (cut off risk).

Following completion of all our risk assessment activities, we have concluded there is a significant risk in respect expenditure recognition in the incorrect accounting period (cut-off) risk, which we consider could result in a risk around the completeness (understatement) or existence (overstatement) of accrued expenditure and payables.

Our response

We performed the following procedures designed to specifically address the significant risk:

- We evaluated the design and implementation of the controls in place for manual expenditure accruals;
- We inspected a sample of invoices of expenditure, in the period around 31 March 2023, to determine whether expenditure was recognised in the correct accounting period; and
- We performed a search for unrecorded liabilities by selecting a sample of expenditure items paid from the Council's bank accounts in the period following year-end, and confirming that those relating to 2022/23 expenditure was accrued appropriately at year- end.

Our findings

We have not identified any fraudulent expenditure recognition during our testing. We have not identified any material misstatements from our completed procedures.

Auditing Standards requires where we have identified a significant audit risk, for management to have a review control in place (MRC) to respond to the risk. We have not identified such a MRC that is designed and implemented in such a way to provide the level of precision, response, investigation, and follow up needed by the Auditing Standards. However, the Council has a number of year end processes including a journal approval process which authorises the year end accruals as they are entered into the General Ledger; and budgetary controls that assist in identifying unusual or unexpected variances from budget. Management considers these arrangements are sufficient to address the Council face.

Audit Risks and our audit approach

4- Management override of controls

Significant Audit risk

Risk: Liabilities Professional standards require us to communicate the fraud risk from management override of controls as significant.

Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

We have not identified any specific additional risks of management override relating to this audit.

Our response

- Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we evaluated the design and implementation and, where appropriate, tested the operating effectiveness of the controls in place for the approval of manual journals posted to the general ledger to ensure that they are appropriate;
- We analysed all journals through the year and focused our testing on those with higher risk, such as journals with unusual expenditure code combinations;
- We assessed the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates;
- We reviewed the appropriateness of the accounting for significant transactions that are outside the Council's normal course of business, or are otherwise unusual; and
- We assessed the controls in place for the identification of related party relationships and tested the completeness of the related parties identified. We verified that these have been appropriately disclosed within the financial statements.

Our findings

- We identified 21 journal entries and post closing journal meeting our high-risk criteria
- our examination did not identify any inappropriate entries.
- We evaluated accounting estimates and did not identify any indicators of management bias. See page 15 for further discussion.
- We did not identify any significant unusual transactions.
- We did not identify any issues from our related parties testing.

Key accounting estimates – Overview

Our view of management judgement

Our views on management judgements with respect to accounting estimates are based solely on the work performed in the context of our audit of the financial statements as a whole. We express no assurance on individual financial statement captions. Cautious means a smaller asset or bigger liability; optimistic is the reverse.

Asset/ liability class	Our view of management judgement			Balance (£m)	YoY change (£m)	Our view of disclosure of judgements & estimates			Further comments
	Cautious	Neutral	Optimistic			Needs improvement	Neutral	Best practice	
Assets Valuation of other land & buildings and Investment Properties				£344	+38				<p>The Assumptions used by the Council Valuer in determining the obsolescence rates used in valuing the depreciated replacement costs are optimistic.</p> <p>The allowance made for external works (areas surrounding assets) is also generally optimistic.</p> <p>We recommended enhancement to the sensitivity disclosure in the accounts.</p> <p>As outlined in Note 4 Assumptions – sensitivity analysis is provided to the reader for every 1% change in obsolescence has a £0.5m movement in the overall valuation</p>

Key accounting estimates – Overview

Our view of management judgement (continued)

Asset/ liability class	Our view of management judgement	Balance (£m)	YoY change (£m)	Our view of disclosure of judgements & estimates	Further comments
	<div style="display: flex; justify-content: space-between; width: 100%;"> Cautious Neutral Optimistic </div>			<div style="display: flex; justify-content: space-between; width: 100%;"> Needs improvement Neutral Best practice </div>	
Liabilities					
LGPS Defined Benefit Obligation		15	+40		KPMG actuaries have reviewed the actuarial valuation for the Orkney Pension Fund, considered the disclosure implications and compared the actuarial valuation to our internal benchmarks. Overall we consider the assumptions adopted to be balanced.

Other estimates

We have also reviewed the following non-significant estimates as part of our audit work

- Depreciation

Group involvement – significant component audits

Involvement in group components

The Council management have assessed on the basis of materiality and significant influence that the Group financial statements are made up of the following components:

We have assessed from a Group perspective the following:

- Orkney Islands Council (Parent) (**significant**);
- Orkney Integration Joint Board (**significant**);
- Orkney Ferries Limited (**non-significant – testing of specific balances**);
- Pickaquoy Centre Trust (**non-significant**); and
- Hammers Hill Energy Limited (**non-significant**).

As communicated in our audit plan we determined that the parent Council and the Orkney Integrated Joint Board were significant components. We performed testing of specific balances for Orkney Ferries Limited and we have performed risk assessment procedures over the remaining components in order to confirm that there were not material balances within the other entities that could cause a material error and did not identify any exceptions.

We did not identify any errors as a result of the procedures set out above.

Other matters

Annual report

The Local Authority Accounts (Scotland) Regulations 2014 require the inclusion of a management commentary within the annual accounts, similar to the Companies Act requirements for listed entity financial statements. The requirements are outlined in the Local Government finance circular 5/2015.

We are required to read the management commentary and express an opinion as to whether it is consistent with the information provided in the annual accounts. We also review the contents of the management commentary against the guidance contained in the local government finance circular 5/2015.

- We have not identified any inconsistencies between the contents of the Management Commentary and the financial statements.
- We have not identified any material inconsistencies between the knowledge acquired during our audit and the Management Commentary. As a Council you confirm that you consider that the annual report and accounts taken as a whole are fair, balanced and understandable and provide the information necessary for stakeholders to assess the Council's performance, business model and strategy.
- We consider the governance framework and annual governance statement to be appropriate for the Council and that it is in accordance with guidance and reflects our understanding of the Council.

Independence and Objectivity

ISA 260 also requires us to make an annual declaration that we are in a position of sufficient independence and objectivity to act as your auditors, which we completed at planning and no further work or matters have arisen since then.

Audit Fees

The base fee for the audit was £224,780.

We have agreed an additional audit fee of £21,500, in respect of the work completed in the year in respect of complex accounting matters considered for the first time and in respect of audit of significant risks which took longer than expected.

We have not completed any non-audit work at the Council during the year.

Wider Scope and Best Value

Financial Management

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

2022/23 budget and performance

The Council formally approved the 2022-2023 budget on 10 March 2022. Spend of £91.3 million was planned in 2022-2023. This was based on estimated funding and power was delegated to the Head of Finance, in consultation with Chief Executive, to revise the general fund revenue budget.

The final revised amount of the budget, as reported in the annual financial statements, amounted to £99.9 million. Actual expenditure was £99.3 million.

- Education – (Overspend) Increased expenditure, amounting to £1.2 million, in relation to pay and grading which includes backpay to 01 April 2021. Utility and property maintenance costs also contributed to the increased amount.
- Orkney Health and Social Care – (Overspend) Increased expenditure in relation to pay and grading which includes backpay to 01 April 2021. Recruitment pressures have also resulted in the requirement to use agency staff to cover essential posts, which costs a premium. These resulted in an overspend of £1.8 million.
- Roads and Transport – (Overspend) Winter maintenance costs for 2022-23 were high. Income in respect of car parks was less than anticipated. Increase cost of internal air contracts, as higher fuel costs were passed on by the operator. Overspend resulting from above amounted to £1.2 million.
- Other Services – (Underspend), reduced expenditure of £5.5 million, on loan charges due to slippage on the planned delivery of the capital programme.

The Council's financial performance shows a deficit on the provision of services of £37.4 million as opposed to the budgeted deficit of £9 million. The annual accounts provide a reconciliation between the planned and actual surplus/deficit, including the accounting adjustments to arrive at the amount of deficit as per the financial statements.

The Council continues to make significant capital investment with £22.3 million being spent in 2022-23. Funding of capital expenditure mainly included £1.4 million from capital receipts, £10.7 million of grants with the balance of £10.5 million being met through internal funding and borrowing.

The Council reported an underspend of £15.1 million due to the expenditure not meeting the profile assumed in the capital programme. A detailed capital overrun report was presented to the Policy and Resources Committee dated 19 September 2023.

Wider Scope and Best Value

Financial Management (continued)

The net assets of the Council has increased by £103.7 million from £703.6 million as at 31 March 2022 to £807.3 million as at 31 March 2023. The main contributors were:

- Long term assets – the increase reflects the rolling programme of revaluations carried out during this financial year.
- Current assets – a reduction mainly due to a loss in the value of externally managed investments of the Strategic Reserve Fund and a reduction in cash balances at the balance sheet date.
- Usable Reserves – the decrease on usable reserves can be attributed to a reduction on both earmarked and unearmarked reserves. There is also a reduction in Harbour Authority Fund as a result of the loss on the Strategic Reserve Fund.
- Unusable Reserves – the increase on unusable reserves can be attributed to the large revaluation gain on the pension asset.

2023/24 budget

In March, 2023 the Council agreed its 2023/24 budget based on the recommendation from the Policy and Resources Committee dated 23 February 2023. General fund revenue budget was set at £101.7 million.

When setting the budget and Council Tax levels for 2023/24, the Council delegated powers to the Head of Finance, in consultation with the Chief Executive and the Section 95 Officer, to prepare and distribute a detailed budget incorporating all the budget adjustments agreed by the Council, and any settlement updates and/or clarifications unknown as at 23 February 2023.

Following above a detailed budget was presented to the Policy and Resources Committee dated 20 June 2023 and was recommended for approval to the Council. The Council approved the detailed budget in their meeting dated 4 July 2023.

The approved budget exceeds the previous budget by 8.1 million. The main contributing factor to this relate to inflation and service pressures amounting to £5.2 million and £1.9 million respectively.

Wider Scope and Best Value

Financial Management (continued)

The detailed revenue budget incorporates budgets for the following services:

- General Fund Services.
- Housing Revenue Account.
- Scapa Flow Oil Port.
- Miscellaneous Piers and Harbours.
- Orkney College.
- Corporate Holding Accounts.
- Strategic Reserve Fund.
- Orkney Islands Council Pension Fund.

Funding gap identified for 2023/24 amount to £16.7 million. The identified gap is planned to be mainly bridged through strategic reserve contribution, general fund reserves utilisation, new charges and efficiencies and service redesign amounting to £6.4 million. £9.3 million, £0.9 million and £1 million respectively.

Budget Monitoring



Quarterly revenue expenditure monitoring reports are presented to Individual Service committees. Additionally annual expenditure monitoring reports are presented to the Policy and Resources Committee. Annual monitoring reports in relation to 2021/22 and 2022/23 were presented to the committee dated 20th September 2022 and 19th September 2023.

Internal Audit

Internal Audit charter for the periods covering 2022 to 2024 was presented to the Monitoring and Audit Committee dated 9 June 2022 and was approved.

The annual report for 2021/22 was presented to the committee dated 25th August 2022 and noted that the Council has a framework of controls in place that provides adequate assurance regarding the organisation's governance framework, internal controls, and the management of key risks. 21 out of 25 planned audits were reported as complete. 4 audits were deferred to 2022/23.

The annual report for 2022/23 was presented to the committee dated 31st August 2023 and noted that the Council has a framework of controls in place that provides adequate assurance regarding the organisation's governance framework, internal controls, and the management of key risks. 24 out of 29 planned audits were reported as complete. 3 audits were deferred to 2023/24 and 1 audit was deferred to 2024/25. Roads operations audit was deferred second year in row.

Wider Scope and Best Value

Financial Management (continued)

Of the completed audits limited opinion was expressed in relation to the contract managed services which implies that there are significant weaknesses in the framework of governance, risk management and control such that it could be or become inadequate and ineffective. Contract management is the administration of contracts between a company and its suppliers. The objective of this audit was to review contract management within Orkney Health and Social Care, including the policy and process for their governance, how they are entered into and how supplier performance is scrutinised and monitored.

The report included three medium priority recommendations concerning procurement and contracts and three low priority recommendations concerning complying with the Council's Contract Standing Orders and contract monitoring. Following were the key medium graded recommendations:

- Processes must ensure that external services engaged by OHAC are engaged by a written contract and in an approved form.
- Processes should ensure that contract award notices are published on the PCS in all required instances in compliance with legislation, as long as disclosure is not an issue (due to small population size)
- Processes and Controls should be put in place to ensure that all regulated procurement agreements entered into are recorded on the Council's contract registers.

The 2021/22 Annual Audit report recommended that Internal Audit should provide updates to those charged with governance on the progress the Council has made in implementing agreed audit actions. First progress report in relation to Internal Audit recommendations was reported on 8 June 2023.



A self assessment in relation to compliance with the public sector Internal Audit standards was presented to the committee dated 21 September 2023 which did not report any partial or non-compliance.

Internal controls

As part of our audit, we identify and assess the key internal controls relevant to our audit. Our objective is to plan and seek assurance, where relevant, that the body has controls around recording and processing transactions to provide a sound basis for the preparation of the financial statements. Overall financial systems of internal control operated effectively, with the exception of the following:

Fraud prevention mechanisms

The Council is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption. Furthermore, it is responsible for

Wider Scope and Best Value

ensuring that its affairs are managed in accordance with proper standards of conduct by putting effective arrangements in place.

Financial Management (continued)

There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption enacted through the anti fraud and corruption policy and whistleblowing policy. We noted that the policy notes that it is subject to review every three year however was last reviewed and updated in 2019. We recommend periodic review and update of this policy.

Recommendation one

The National Fraud Initiative (NFI) is a counter-fraud exercise across the UK public sector which aims to prevent and detect fraud. We note that the Council recognised the need for and participates in the initiative. The investigations for NFI matches related to 2022/23 are currently under way. We understand that as of November 71% of the reported matches have been processed.

Financial regulations

The standing financial regulations are comprehensive and available on the website for public access. The publicly available policy was last updated July 2019. We recommend periodic review and update of this policy.

Recommendation two

Going Concern

The Council's Group Accounts have been prepared on a "going concern" basis as it is expected that future local government finance settlements, aligned with the budget process, which drives through efficiency savings, will provide sufficient resources to finance future liabilities.

Conclusion

The 2023-24 budget was set in March 2023 and financial balance is achieved in the short term.

A budget monitoring system is in place.

Overall financial systems of internal control are operating effectively.

There are established procedures for preventing and detecting fraud.

An established Internal Audit system is in place.

Policies and procedures need to be reviewed and refreshed on a timely basis.

Wider Scope and Best Value

Financial Sustainability

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Medium term financial strategy (MTFS)

The Council's latest financial strategy update covers the period 2023/24 to 2027/28. The plan with the latest update was presented to the Policy and Resources Committee and the Council and was approved dated 20 June 2023 and 4 July 2023 respectively. The strategy identifies the following key financial risk areas faced by the Council over the medium term:

- Scottish Government funding reductions.
- Pay awards.
- General inflation (including energy costs).
- Ageing population.
- Housing shortages.
- Recruitment and retention.
- Increasing levels of need.
- Increased cost of borrowing.

Strategy notes that the potential funding gap faced by the Council may amount to £27.1 million over the period covered by the MTFS and recognises the need for delivering savings to achieve financial balance.

The projections produced contain several assumptions which are considered most likely by the Council:

- Staff costs – 2% increase over the forecast period assuming wage increases will fall back in line with projected inflation.
- Property costs – 15% in 2024/25 representing known pressure re energy costs followed by 3% per annum over the remaining period
- Budget uplifts – 3% increase on annual basis.
- CPI on charges – 7%, 4% and 2% for 2024/25, 2025/26 and remaining forecast period respectively.



The Medium-Term Financial Strategy includes an analysis of best and worst case scenarios as part of the financial planning. The risks associated with the assumptions in the MTFS include forecast error, economic performance (including inflation assumptions), changes to Scottish Government spending, political pressure, and demand-led need. The best and worst case scenario result in a funding gap of £25.8 million and £28.5 over the forecast period.

Wider Scope and Best Value

Financial Sustainability (continued)

The strategy identifies that following options are available to bridge the funding gap:

- Increasing Council Tax to national average during term of this Council.
- Fee income generation.
- Access external funding streams.
- Lobby for fairer settlement, in total and in focused areas.
- Efficiency measures, and reduction in bureaucracy.
- Service redesign.
- Capacity building within communities – working with NHS Orkney and 3rd sector.
- Recycle in year savings, other reserves, and balances, for example advance use of wind farm revenues from Strategic Reserve Fund.

Although the strategy has identified the options available to bridge the gap, detailed plans at operational/service level are required to be developed and implemented to ensure achievement. The 2023/24 budget as well the medium term strategy identify the use of reserves to bridge the funding gap however pressures on investment returns and strategic reserve fund and falling general fund balances make this approach untenable on an ongoing basis. The MTFS was set with the understanding that Council Tax levels would increase to national average over the life of the MTFS. The recent Scottish Government announcement that all Council Tax levels for 2024/25 be frozen will put further pressure on the Council to identify options to bridge the gap over the medium to longer term and increasing the risk to financial sustainability.

We recommend that the Council now needs to continue to develop specific plans to bridge the gap in a sustainable manner.

Recommendation three

Equalities Impact Assessment was carried out as part of the development of the MTFS and presented for consideration along with the presentation of the MTFS for approval to the Policy and Resources Committee. Island Communities Impact Assessment was not carried out as part of MTFS development as it was considered unlikely to have an impact by the Council. We recommend that the Council should review the applicability of this assessment as part of the development of all plans, ensuring it is completed in respect of service redesign arising from the MTFS.

Recommendation four

The Council plan identifies securing a new fleet of green ferries as one of the biggest challenges, under the developing our infrastructure theme, in light of the ageing fleet. Further associated performance measures and action points have been identified as part of the Council plan and Council delivery plan respectively. The Scottish Government has agreed to the further funding of a business case to investigate replacing Orkney's internal ferry fleet. The agreement was reached at the third meeting of the Orkney Internal Ferry Replacement Task Force.

Wider Scope and Best Value

Financial Sustainability (continued)

This now requires the Council to build an agreed business case for ferry replacement, providing the resources required for work to scope out options and to carry out physical investigative works around Orkney's pier and harbours infrastructure including assessment of the impact on the future budgets and the medium term financial strategy.

Capital Projections

The Council's existing capital programme includes approved capital project expenditure of £61,538,000 over the 3-year period 2023 to 2026 which, after allowing for £45,449,000 in respect of use of reserves, capital receipts, capital grants and revenue contributions, leaves an identified capital financing borrowing requirement of £16,089,000. The MTFS notes that the capital programme for the future years is being developed and will need to be incorporated in the future revenue budgets to fully integrate the revenue and the capital budget process.

2021/22 Annual Audit report recommended minimisation of recurring capital slippage which continues to occur in 2022/23 as noted in the financial management section. The Council delivery plan, which is a key document in relation to implementation of the Council plan, identifies the action plan in relation to capital program under the theme of "Developing our Infrastructure". The action plan identifies the objective to finalize and approve the new capital program in 2024/25 along with the monitoring of the current capital programme.

Strategic Reserve Fund (SRF)

The purpose of the Strategic Reserve Fund is to provide for the benefit of Orkney and its inhabitants including the development of one-off strategic capital projects. The Strategic Reserve Fund is also supporting the level of General Fund Services as part of an agreed Medium Term Financial Strategy. For the financial year 2022-23 £8.26M from the Strategic Reserve Fund was used as a funding source to supplement the General Fund Services revenue budget. The approved contribution from the Strategic Reserve Fund for 2023/24 was set, together with indicative budgets for 2024/25 and 2025/26, at £6.35m.



One of the key principles of the medium term financial strategy is to ensure sustainable use of strategic reserves keeping in view the fund's commitment in relation to long term decline and potential decommissioning cost to the Council of the Flotta Oil terminal in future amounting to £36.5 million as per the latest financial statements. The fund is currently operating below the floor value of £225 million set by the Policy and Resources Committee on 21 December 2021. Keeping this in view the contribution from the Strategic Reserve Fund has been limited to £6.35 million over the period of the medium term financial strategy. While there is a level that can be utilised, overuse of strategic reserve fund is not sustainable as part of the longer term financial plans and strategy. We recommend that the Council should carry out detailed analysis to develop a strategy in relation to sustainable use of the strategic reserve fund taking into account the long term commitments/plans of the Council which are expected to be settled/implemented through

Wider Scope and Best Value

the use of the fund balance.

Recommendation five

Financial Sustainability (continued)

Reserves Strategy

The General Fund Reserves Strategy was reviewed by the Policy and Resources Committee in February 2023. As at 31 March 2022, the Council held reserves and balances totalling £44,273,000. As a result of the review, £10.6m of previously earmarked General Fund balances were to be reprovionised as non-earmarked General Fund balances. The review of the Reserves strategy agreed for the non-earmarked General Fund balance be set at 2% of the 2023/24 revenue budget as a contingency for in year pressures

Savings Plans

The strategy includes an action plan for addressing the identified funding gaps over the period of the forecast. The Council plans to bridge funding gaps through a mix of savings, use of reserves, funding and new charges. MTFS included target specifically related to savings, through efficiencies and service redesign, over the period of MTFS amounting to £4.8 million. The targets are monitored as part of budget monitoring reports. The MTFS recognises that no closures of cuts are proposed immediately however ultimately savings generated through “efficiencies and service redesign” will incorporate some closures or cuts brought forward by services. The Council and its partners have limited officer capacity and has limited ability to increase workforce capacity to deliver the required changes within the service delivery plans. Detailed service level plans to support implementation of these plans are required as noted in recommendation 3.

Conclusion

MTFS is in place and takes into account scenario analysis and planning.

Options to bridge the identified funding gaps have been identified as part of the MTFS.

Detailed plans at operational/service level are required to be developed and implemented to ensure achievement of measures identified in the MTFS.

The 2023/24 budget as well the medium term financial strategy identify the use of reserves to bridge the funding gap however pressures on investment returns and strategic reserve fund and falling general fund balances make this approach untenable in the medium term.

The Council has a capital programme in place extending to 2026.

The MTFS notes that the capital programme for the future years is being developed and will need to be incorporated in the future revenue budgets as well as the MTFS to fully integrate the revenue, the capital budget process and the medium term financial plan.

2021/22 Annual Audit report recommended minimisation of recurring capital slippage which continues to occur in 2022/23.

The Council has a reserves strategy in place

The Council should carry out detailed analysis to develop a strategy in relation to sustainable use of the strategic reserve fund taking into account the long term commitments/plans of the Council which are expected to be settled/implemented through the use of the fund balance.

Wider Scope and Best Value

Vision, leadership and Governance

Vision, leadership and governance is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

The governance framework is the system by which the Council leads, directs and controls its functions and relates to the community and other stakeholders. It includes the systems, processes, cultures and values through which the Council strives to adhere to the principles of good governance of openness, inclusivity, integrity and accountability. The Council's corporate governance is underpinned by the CIPFA/Solace Framework 'Delivering Good Governance in Local Government'. A revised edition of the Framework was published in early 2016 and the Local Code of Corporate Governance was updated to reflect the 2016 edition of the Framework. The Council adopted the revised Local Code of Corporate Governance in 2017. Review was carried out and revisions to the code were approved in October 2022. The updated code is published on the Council's website for public access. The Council has adopted a code of conduct for its employees and councillors which has been published on the website for awareness and public access. Arrangements are in place to ensure Members and officers are supported by appropriate learning and development.

Strategy



The overarching strategic vision of the Council is detailed in the Council's Plan which sets out the key outcomes the Council is committed to delivering with its partners. The plan extends for 5 years from 2023 to 2028. The plan is available for public's access on the Council's website. The Council plan is accompanied by a delivery plan. This Delivery Plan complements and supports Orkney Islands Council's strategic plan for the current Council term. The Delivery Plan describes some of the projects, services and policies which will progress priorities of the Council plan and achieve tangible outcomes for Orkney. The Council's Performance Management Framework sets out the process for monitoring performance against the strategic objectives. Priorities under the strategic plan are aimed to be delivered through service delivery plans. The Directorate Delivery plans and the performance management framework aligned with the new Council plan are in the process of development.

Involvement of Stakeholders



Consultation relating to this plan was carried out in two stages. As part of the first stage the Council conducted a consultation exercise under the banner 'Orkney Matters'. This exercise included a questionnaire, a series of online meetings, and dedicated sessions for schools and community groups, which used art to engage with people less likely to respond through regular channels. The second stage was a public consultation on the draft plan itself


Wider Scope and Best Value

before the plan was finalised



Wider Scope and Best Value

Vision, Leadership and Governance (continued)

 The Council acknowledges the vulnerabilities of the remote communities like the ferry-linked isles as part of the development of the Council plan and have community specific performance measures and actions plans as part of the Council plan and Council delivery plan respectively.

Equalities Impact Assessment and Island Communities Impact Assessment were carried out as part of the development of the plan and presented for consideration along with the presentation of the Council plan for approval to the Policy and Resources Committee.

Setting and reporting of operational performance

In order to monitor and review progress the Council plan lays out performance measures and specified targets for each theme, to be achieved by the conclusion of the Council plan, which includes the three priority themes and the overall theme of transforming the Council. Some performance measures and targets are taken from the Orkney Partnership's Community Plan and some are taken from the Local Government Benchmarking Framework (LGBF).

Council services produce their own information to monitor performance and guide decision-making which are yet to be developed as part of the individual service plans. Working with their services, the Council has chosen the key measures to assess progress against their priorities, and performance against these will be reported each year. These are set out in the Council plan.

Governance statement

As part of our audit process we review the Annual Governance Statement in the annual report and accounts. Governance statement is reviewed and approved by the relevant committees of Council ahead of being published as part of the annual accounts. The arrangements are appropriate and operated effectively during 2022/23.

Standing Orders, Schemes of Delegation and Financial Regulations

The Council operates within an established procedural framework. The roles and responsibilities of Elected Members and officers are defined within the Council's Standing Orders and Scheme of Administration, Contract Standing Orders, Scheme of Delegation and Financial Regulations. These are subject to regular review.

We have considered financial regulations as part of financial management in an earlier section.

Risk Management

In order to manage and monitor its risks, the Council has an approved risk management strategy for the periods from 2022 to 2024.

Wider Scope and Best Value

Vision, Leadership and Governance (continued)

The policy requires the review and maintenance of risk registers (corporate and directorate). Corporate risk registers were presented to the Policy and Resources Committee periodically however directorate risk registers were last presented in June 2021. Additionally, the Internal Audit report on corporate governance and risk management, dated 26th January 2023, identified action points for improvement. We recommend that the risk management actions as identified in the risk management strategy should be implemented in full.

Recommendation six

The overall opinion expressed by Internal audit was adequate.

Scrutiny, challenge and transparency

Status of progress of audit recommendations and action points are regularly reported and considered by the Audit Committee. Committee minutes and related documents are available on the website for public scrutiny. The Council maintains a website where users can find further wide range of information about the Council including documents relating to strategies, policies and performance.

Alternative models of Governance

A reported titled “Alternative models of Governance” was presented to the Policy and Resources Committee dated 19th September 2023. Purpose of the report was to consider the scope of work, together with the resources required, to explore options for alternative models of governance that would provide greater fiscal security and economic opportunity for the Islands of Orkney. This was in pursuance of a notice of motion on alternative governance arrangement presented to the Council on 4 July 2023.

The Council had resolved:

- that the Notice of Motion be supported, in that options for alternative models of governance, that would provide greater fiscal security and economic opportunity for the islands of Orkney, be explored.
- that the Chief Executive should submit a report, to the Policy and Resources Committee, detailing the scope of work, together with the resources required, to address the matters raised in the Notice of Motion.
- that, in addition, the Constitutional Reform Consultative Group be reinvigorated, with officer support, to pursue, amongst other things, opportunities from the National Islands Plan, the Islands (Scotland) Act 2018 (such as the ability to request additional powers), and to develop the Single Islands Authority work, continuing to hold to account the national governments on the commitments they made to empower the islands and level up, as well as exploration of options for alternative models of governance as referred to in the Motion.

Wider Scope and Best Value

Vision, Leadership and Governance (continued)

It was proposed that the scope of works be progressed as a project and delivered in a staged approach.

The key stages are as follows:

- Agreeing the scope of work for the Constitutional Reform Consultative Group;
- Progression of selected options with further scoping of political, legal, and financial implications and consultation and engagement with the Orkney public;
- Development of the chosen option or options including addressing financial and legal implications; and
- Delivery of the approved option.

The reports estimates that the dedicated staff resources initially required will be 1 full time equivalent post for the first stage, and it is proposed to meet this from within existing resources. Additionally, investigation, reporting and subsequent public consultation will require further resource in terms of officer time during the first stage.

Conclusion

Council has effective strategic planning in place. Service plans to support the delivery of strategic plans and objectives are in the process of development.

Action is ongoing to develop Directorate Delivery plans.

The Medium-Term Financial Strategy identifies a funding gap and high level approaches to address this but specific plans are now required to ensure it is addressed. These will need consideration in respect of equality impact and take time and resources to implement. The Council has limited annual financial resources and officer capacity to plan and enact strategic change.

Governance arrangements are appropriate and operated effectively.

Implementation of the approved risk management strategy needs improvement.

Arrangements are in place in relation to security, challenge and transparency

Alternative models of governance are being considered and will require significant analysis to assess the potential financial and legal impacts both of the alternatives and additional powers that may be available to the Council and the value it obtains from spending in pursuit of their consideration.

Wider Scope and Best Value

Use of resources to improve outcomes

Audited bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities. This includes demonstrating economy, efficiency, and effectiveness through the use of financial and other resources and reporting performance against outcomes.

The Council's Strategic Planning and Performance Framework describes the elements that make up the Council's strategic planning and performance arrangements, and its role in the strategic planning and performance arrangements of the Orkney Partnership. The framework goes on to describe the Council's arrangements for service and corporate self-assessment, service planning, workforce planning, and the management of risk, performance and business continuity. As noted earlier this was set in 2019 and needs to be updated to align with the new Council plan. Public Performance Reporting is a requirement carried out largely through the Council's Public Performance Reporting (PPR) webpages of the Council's website. The PPR webpages contain a wide variety of performance reports, for example, the Council's Annual Performance Report, six-monthly Council Plan Monitoring Reports and six-monthly service plan performance reports. Further a sub-section of the performance section of the webpage relates to "Public Performance Reports within Particular Council Areas" which is aimed towards providing easy access to the various Council reports and publication containing performance information which may be of interest to the general public. The information and progress updates on these pages are not up to date. Latest available information in relation to the service performance relates to September 2021.

The Council's Annual Performance Reports are structured around Council priorities, and use various measures to show how well the Council performed during particular years. The annual performance report for 2021/22 is available for public access on the Council's website. The 2022/23 report is yet to be published. The performance report reports achievement against the action points identified in the Council delivery plan aimed towards satisfaction of the key themes identified in the Council plan 2018-23 and best value. This is based on performance reporting, against the delivery plan, reported to the Policy and Resources Committee on a periodic basis. The performance is reported as follows:

- BLUE = Completed.
- RED = Overdue/Significant underperformance with a medium to high risk of failure to meet the target.
- AMBER = Minor underperformance, with a low risk of failure to meet the target.
- GREEN = On target.

Out of all action points 10 were reported as red and 4 were reported as amber as compared to 16 red and 10 amber in the previous period. 2021/22 report includes the achievement in relation to the best value action points which were not reported in 2020-21 report.

Wider Scope and Best Value

Use of resources to improve outcomes (continued)

Although the annual performance reporting is being carried out to report achievement of strategic objectives, it will be more beneficial to report this in form of quantifiable key performance indicators (KPIs) as opposed to narrative reporting. Quantitative KPIs have been developed under the new Council plan and will form the basis 2023/24 performance reporting.

The Local Government Benchmarking Framework (LGBF) brings together a wide range of information about how all Scottish Councils perform in delivering services to local communities. The LGBF assists Councils in benchmarking their performance in key areas and creates opportunities to identify and share good practice. The link to LGBF dashboard is provided on the Council's website as well as the annual accounts, which allows visualization of the Council's performance by service areas and indicators. Additionally the Councils reports the same in summary in the form of a performance report which is available for public access on the performance webpage. The latest available report on the webpage report relates to 2020/21. Performance report in relation to 2021/22 was presented to the Policy and Resource Committee dated June 2023 which included a clear focus on reporting on LGBF indicators which were related to priorities in the Council Plan as a specific appendix, followed by other indicators which while important, were not specifically associated with Council priorities.

As reported in relation to 2021/22, of the 19 LGBF indicators the Council identifies as aligned with the Council Plan priorities, 5 indicate the Council is in the top quartile of Councils, 5 indicate the Council is in the second quartile and it is in the bottom two quartiles for the remaining 9. Context and trend data is provided for each of these indicators.

Taking into account all indicators, as per the latest published data the Council's performance has improved or stayed the same as compared to the prior year and base year in relation to 52% and 55% of the indicators. The percentage of indicators in top 2 quartile reduced from 55% to 50%.

The lowest percentages in relation to indicators in the top 2 performance quartiles related to cost indicators, corporate services and housing services categories i.e. 30%, 36% and 20% respectively. Performance against cost and corporate services has improved as compared to base year. A root cause analysis should be carried out to monitor the observed trend in performance.

Recommendation seven

Conclusion

Performance management arrangements provide a sound base for improvement however further improvements can be made through development, monitoring and reporting in the form of quantifiable KPIs.

Performance related information on the Council's webpage should be continuously monitored and kept up to date.

Wider Scope and Best Value

The Publication of Information (Standards of Performance) Direction 2021 Statutory Performance Indicators

The Accounts Commission issued a new Statutory Performance Information (SPIs) Direction in December 2021 which applies for the three years from 2022/23

Direction requires a Council to report its:

- performance in improving local public services (including those provided with its partners and communities), and progress against agreed desired outcomes (SPI 1). The Commission expects this reporting to allow comparison both over time and with other similar bodies (drawing on Local Government Benchmarking Framework and/or other benchmarking activities).
- own assessment and audit, scrutiny, and inspection body assessments of how it is performing against its duty of Best Value, and how it has responded to these assessments (SPI 2).

Details of how the Council complies with requirements of SP1, along with the related recommendations, are included in the “Use of resources to improve outcomes” slide.

Starting from 2021/22 the annual performance report includes a separate section which reports performance against the previous best value recommendations. The Council has a system in place to report regular updates in relation to the achievement of strategic objectives to the Service Committees and the Policy and Resources Committee in the form of monitoring of the Council delivery plan. Link to this information is provided in the performance webpage of the Council. However as noted above the relevant sections of the same need to be updated to provide link to the latest reporting. The latest reporting is currently accessible through accessing the minutes of the relevant committees.

Progress against action points emanating from external and internal assessments is reported to and monitored by the Policy and Resources Committee and are accessible by public through the minutes of the meetings of the relevant committee. Additionally, the performance section of the website includes a sub-section relating to best value which provides documents/ links to relevant sections of the website in relation to internal and external assessments with respect to best value. The Council Plan 2023-28 was published for consultation, which also included the performance measures mapped against the desired outcomes and key themes. This enabled the respondents to consider and comment on the meaningfulness of the performance indicators. The plan was updated in light of the responses and presented to the Policy and Resources Committee dated 21 February 2023. The Council has made arrangements related to self-evaluation of services.

Conclusion

Council has made arrangements to comply with the SPI Directions.

Wider Scope and Best Value

Climate Change

The Auditor General and Accounts Commission are developing a programme of work on climate change. This involves a blend of climate change-specific outputs that focus on key issues and challenges as well as moving towards integrating climate change considerations into all aspects of audit work.

For 2022/23 audits, auditors are required to provide answers to specified questions which are intended to gather basic information on the arrangements for responding to climate change in each body.

The Council has a carbon management programme in place. The programme runs from 2016 to 2026. The main aim identified under the programme is to reduce the carbon emission by 42% by 2025 as compared to the base levels relating to 2004/05.

The Council reports performance against this target to the sustainable Scotland network. As per the latest published return, relating to 2021/22, 18% reduction has been achieved. As per the reported data carbon footprint for 2021/22 has increased as compared to the prior year.

Aim to become net zero by 2030 was included as an aim in the latest Council plan extending for a period from 2023 to 2028. The strategic plan also identifies relates performance measures in relation to Carbon emissions under the growing our economy theme with reduction targets being set, for 2027/28, against 2020/21 baseline in relation to the following two measures:

- CO2 emissions area wide per capita (in tonnes)
- CO2 emissions area wide: emissions within scope of local authority per capita (in tonnes).

Net zero and de-carbonisation has been included in the Council delivery plan developed to support the implementation of the Council plan 2023-28. The Council delivery plan identifies series of actions relation to progress towards net-zero.

Following are the details of the action identified in the delivery plan:

- Working with partners in the renewable research and innovation community.
- Finalisation, approval and implementation of relevant actions in the Orkney Sustainable Energy Strategy and Action Plan.
- Decarbonisation of vehicle fleet and Council buildings and properties with reference to the Scottish Government Local Heat and Energy Efficiency Strategy.
- Progressing delivery plan to meet Energy Efficiency Standard for Social Housing 2 by 2032 in line with Scottish Government priorities and availability of funding.
- Supporting uptake of renewable energy, smart energy, or energy efficient solutions for homes and businesses.

Wider Scope and Best Value

Climate Change (continued)

Following immediate actions are laid down for 2023/24:

- Finalise the Orkney Sustainable Energy Strategy Action Plan.
- Council specific action will follow from this delivery plan.
- Commence development of the Council Climate Change Strategy and Action Plan

An update on progress was presented to the Policy and Resources Committee dated 19th September which proposed a draft timeline for progressing the climate change strategy which includes a target year 20224/25 for the approval of the climate change strategy and action plan.

Examples of climate friendly projects include work being done in relation to wind energy. Orkney Islands Council is developing Orkney Community Wind Farms with an aim to generate income and harness Orkney's natural resources. The project consists of three developments at Quanterness, Hoy and Faray. Planning permission has been obtained for all three sites. The Council identifies the completion of the windfarm project as one of the outcomes in it's Council plan under the "Developing our Infrastructure" theme.

Development of the climate specific strategies and action plans will also require the consideration of the existing and future energy projects and infrastructure throughout Orkney to ensure that the Council's expectations and understanding are effectively aligned throughout its plans.

Financial statements include details of climate related initiatives however do not include details of the areas of financial statements expected to be materially impacted in relation to climate change.

The Council should action the development of climate relates strategies and associated action and delivery plans including incorporation of the impacts of the identified climate related initiatives in the future budgets and the medium-term financial plan.

(Thematic report recommendation)

Conclusion

Climate change has been identified as a strategic priority and associated performance measures and action plans have been developed.

Previous progress has been slow in relation to meeting the identified targets and the set targets under the carbon management plan could not be achieved.

Wider Scope and Best Value

Best Value

Local government bodies have a duty under the Local Government in Scotland Act 2003 to make arrangements which secure Best Value. Best Value is continuous improvement in the performance of the body's functions.

Under the new Code of Audit Practice, the audit of Best Value in Councils is fully integrated within the annual audit work performed by appointed auditors and their teams. Auditors are required to evaluate and report on the performance of Councils in meeting their Best Value duties.

There are the following four aspects to auditors' work:

- Follow-up and risk-based work
- Service improvement and reporting.
- Thematic reviews.
- Contributing to Controller of Audit reports.

Thematic reviews

Auditors are required to report on Best Value or related themes prescribed by the Accounts Commission. The thematic work for 2022/23 requires auditors to carry out an overview of the effectiveness of Council leadership in developing new local strategic priorities following the elections in May 2022. In carrying out the overview, auditors should answer the following questions:

- How clear is the new Council vision and its priorities?
- How effectively have the views of citizens and communities been reflected in priorities and decisions taken by the Council?
- How effectively do the Council priorities reflect the need to reduce inequalities and climate change?
- How good are the delivery plans and is there alignment of financial, workforce, asset and digital plans with the Council's priorities?
- Overall, how effective has the leadership been (political and officer) in setting clear priorities and a sustainable approach to delivering them?

Wider Scope and Best Value

Best Value (continued)

As required by guidance we have issued a separate management report. A summary of our findings are as follows:

- The Council has established a clear vision supported by revised priorities.
- Elected members are close to the communities they serve and can understand their sentiments. The Council has effectively engaged with citizens and communities when developing the priorities however more work is required to provide a platform and resources for engagement on an ongoing basis.
- The Council's priorities have a focus on the need to reduce inequalities and climate change. It has a clear understanding of inequalities faced by its island communities. The previous climate target has not yet been achieved. More work is required to expedite the implementation of the climate change initiative – as reported in our thematic report.
- The leadership been effective in setting clear priorities but now needs to demonstrate sustainable plans for delivering them

Recommendations, in addition to those included in this report, are reported in the Best Value thematic report and relate to:

- Regularly updating performance information on the Council webpage.
- Supporting development of locality plans.
- Considering, as part of the ongoing review, how *ad hoc* and in-year consultation is carried out effectively and that seeking stakeholder views on the proposed and implemented approach.
- Development / highlighting of specific inequality related performance measures and action plans as part of strategic planning.
- Ensuring that completed Equalities Impact Assessment and Island Communities Impact Assessments are carried out in respect of potential service redesign and are readily available in the relevant section of the Council website.
- Ensuring cover papers for financial plans make clear the interdependencies and impact on strategic matters.

Wider Scope and Best Value

Best Value (continued)

Conclusion

Overall the Council continues to make progress in relation to securing best value, particularly in respect of its overarching strategic direction however more work is required to finalise associated Directorate Delivery plans alongside performance monitoring arrangements to ensure its delivery. Financial sustainability is a key focus.

The Council understands its communities and engages with them to inform its planning.

Council has approved strategic planning in place in the form of the Council plan and Council delivery plan. Directorate Delivery plans to support the delivery of strategic plans and objectives are in the process of development. The performance management framework is being refreshed to align with the new Council plan

MTFS is in place and takes into account scenario analysis and planning. High level approaches to bridge the identified funding gaps have been identified as part of the MTFS. Detailed plans at operational/service level are required to be developed and implemented to ensure achievement of measures identified in the MTFS. Capacity to do so is limited.

The 2023/24 budget as well the medium-term strategy identify the use of reserves to bridge the funding gap however pressures on investment returns and strategic reserve fund and falling general fund balances make this approach untenable in the medium term. The Council should carry out detailed analysis to develop a strategy in relation to sustainable use of the strategic reserve fund taking into account the long-term commitments/plans of the Council which are expected to be settled/implemented through the use of the fund balance.








A root cause analysis should be carried out to monitor the observed trend in performance.



Appendi

Contents	Page
Required communications with the Audit Committee	41
Recommendations raised and followed up	43
Audit differences	50
Confirmation of independence	55
KPMG's Audit Quality Framework	57
Changes to auditing standards	59

Mandatory communications

Type		Statement
Our draft management representation letter		We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2023.
Adjusted audit differences		Appendix Three identifies six adjusted audit differences in excess of £200,000. These result in an overall charge to the CIES of £5,010m.
Unadjusted audit differences		We have identified two unadjusted audit differences. See appendix Three.
Related parties		There were no significant matters that arose during the audit in connection with the entity's related parties.
Other matters warranting attention by the Audit Committee		There were no matters to report arising from the audit that, in our professional judgment, are significant to the oversight of the financial reporting process.
Control deficiencies		We communicate to management in this report all deficiencies in internal control over financial reporting of a lesser magnitude than significant deficiencies identified during the audit that had not previously been communicated in writing.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts		No actual or suspected fraud involving group management, employees with significant roles in internal control, or where fraud results in a material misstatement in the financial statements was identified during the audit.

Mandatory communications (continued)

Type	Statement
Significant difficulties	<input checked="" type="radio"/> No significant difficulties were encountered during the audit.
Modifications to auditor's report	<input checked="" type="radio"/> None.
Disagreements with management or scope limitations	<input checked="" type="radio"/> The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.
Other information	<input checked="" type="radio"/> No material inconsistencies were identified relating to other information in the Management Commentary. The Commentary is fair, balanced and comprehensive, and complies with the requirements of the Code.
Breaches of independence	<input checked="" type="radio"/> No matters to report. The engagement team have complied with relevant ethical requirements regarding independence.
Accounting practices	<input checked="" type="radio"/> Over the course of our audit, we have evaluated the appropriateness of the Council's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate.
Significant matters discussed or subject to correspondence with management	<input checked="" type="radio"/> The significant matters arising from the audit were discussed, or subject to correspondence, with management.

Recommendations followed up and raised

We have followed up the recommendations raised in the prior year by Audit Scotland. Below is a table of the actions and implementation. We have disclosed below the recommendations that are still ongoing with the current management response.

Priority rating for recommendations					
1	Priority one: issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.	2	Priority two: issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	3	Priority three: issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

Recommendations (followed up)

Total number of recommendations	Number of recommendations implemented or superseded with new recommendations	Number outstanding (repeated below):
15	14	1

#	Risk	Issue, Impact and Recommendation	Update November 2023
2020-21 Recommendations			
1	3	<p>Council Tax and NDR Controls</p> <p>Controls over NDR and Council Tax In 2020/21 due to Covid-19 and resourcing issues there was no internal review of Council Tax and Non-Domestic Rates discounts and exemptions.</p> <p>Recommendation:</p> <p>The Council should reinstate controls suspended due to Covid-19 as soon as possible.</p>	<p>Management recognises that the review process was put on hold due to Covid-19 and staff resource issues, however, the review process has been reintroduced and the first review to be undertaken is the single-person discount on Council Tax. Other reviews will proceed thereafter.</p> <p>Responsible Officer: Service Manager – Revenues and Benefits</p> <p>Due Date: 30 June 2024</p>

Recommendations 2022-23 (Financial Statements)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
1	2	<p>Flotta Oil Terminal contractual provision</p> <p>The spreadsheet supporting the calculation of the movement of the value of the provision year on year in line with RPI included some formula errors leading to a misstatement of £1.679m</p> <p>Recommendation:</p> <p>Annually carry out a single reconciliation of the balance using the starting RPI to the closing RPI reconciling this to the carrying value of the provision as per the detailed spreadsheet.</p>	<p>The error identified in this year's audit related to miscalculations from several years ago and has now been corrected.</p> <p>A process will be put in place to carry out an annual review of the in-year inflation and the overall inflation from the starting position.</p> <p>Responsible Officer: Service Manager – Corporate Finance</p> <p>Due Date: 30 June 2024</p>
2	2	<p>Fixed Asset Register (FRA) maintenance</p> <p>We found that additions to the FAR were not dated making it difficult to assess whether asset lives / depreciation charged etc were reasonable.</p> <p>We identified that depreciation was not charged in year for assets revalued which potentially could impact different accounting entries.</p> <p>Also there was no evidence of an annual review of ongoing asset lives to assess whether these remain valid based on the evidence of how long assets are actually lasting in operational use.</p> <p>Recommendation:</p> <p>All additions to the FAR are dated for the year of addition.</p> <p>Depreciation is charged on all assets in operational use every year.</p> <p>An Annual review of ongoing asset lives is carried out aligned to ongoing operational use of those assets.</p>	<p>Assets are added as if purchased or developed on 1 April, with a full year of depreciation charged in the year of purchase at year-end.</p> <p>A review of the Fixed Asset Register will be undertaken to see if the annual extract can detail the year of purchase.</p> <p>Processes in place have been agreed with previous auditors, however, this will be changed to ensure depreciation is charged in the year of revaluation and a review of assets held at zero asset lives will be carried out on an annual basis.</p> <p>In addition, a rolling programme of ongoing asset lives will be put in place to ensure they are reviewed regularly.</p> <p>Responsible Officer: Service Manager – Corporate Finance</p> <p>Due Date: 30 June 2024</p>

Recommendations 2022-23 (Financial Statements) - cont

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
3	2	<p>In August 2022, Audit Scotland issued updated guidance in regards to the accounting of Infrastructure assets. Councils which did not meet this requirement could utilise two statutory overrides.</p> <p>For management to meet this requirement they will need to carry out a retrospective review of the methodology used to account for the infrastructure assets and update the methodology accordingly to ensure compliance with the guidance. This did not impact upon our planned audit approach</p>	<p>Noted –</p> <p>The Council intends to make use of the Scottish Government statutory override which is in place until 31 March 2024, to allow time for a permanent solution to be developed within the Accounting Code.</p> <p>The Council has applied both statutory overrides for infrastructure assets. The Council will be alert to guidance on accounting for infrastructure assets issued by CIPFA/LASAAC.</p> <p>Responsible officer: Head of Finance</p> <p>Due Date: 30 June 2024</p>

Recommendations 22-23 (Wider scope and Best Value)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
1	③	<p>The anti-fraud policy notes that it is subject to review every three years. However, it was last reviewed and updated in 2019.</p> <p>There is a risk of obsolete and out of date policies and procedures.</p> <p>Recommendation: We recommend timely review and update of all policy and procedures documents</p>	<p>The anti-fraud policy review has been overlooked but will be carried out over the next 12 months.</p> <p>Responsible officer: Corporate Director of Enterprise and Sustainable Regeneration</p> <p>Due Date: 30 November 2024</p>
2	③	<p>The publicly available financial regulations were last updated July 2019.</p> <p>There is a risk of obsolete and out of date policies and procedures.</p> <p>Recommendation: We recommend timely review and update of all policy and procedures documents</p>	<p>The Financial Regulations are in use on a regular basis, and the Council is aware that they require updating. Work has commenced to review and update the Financial Regulations.</p> <p>Responsible officer: Head of Finance</p> <p>Due Date: 30 June 2024</p>

Appendix two

3	①	<p>MTFS identifies the options available to bridge the identified funding gap. However, detailed plans at operational/service level are required to be developed and implemented to ensure achievement.</p> <p>There is a risk of inability to achieve financial balance.</p> <p>Recommendation:</p> <p>We recommend that the Council should continue to develop detailed service level medium terms plans to bridge the gap in a sustainable manner</p>	<p>The Council plans to achieve a sustainable financial position over the next 3 years through focusing on the following 5 areas.</p> <p>Income generation</p> <p>Service reduction and redesign – including cost reduction opportunities.</p> <p>Changes to ways of working (reducing bureaucracy, delivering efficiencies and improving use of ICT)</p> <p>Financial/budget smoothing</p> <p>Use of reserves</p> <p>Responsible officer: Corporate Directors</p> <p>Due Date: March 2026</p>
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Recommendations 22-23 (Wider scope and Best Value)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
4	2	<p>In terms of the Islands (Scotland) Act 2018, the Council, must prepare an Island Communities Impact Assessment in relation to policies, strategies or services, which, in the Council's opinion, are likely to have an effect on an island community which is significantly different from its effect on other communities (including other island communities) in the area in which the Council exercises its functions.</p> <p>There is a risk of failure to identify equality impacts.</p> <p>Recommendation: We recommend that the Council considers the applicability of such assessments when revising policies/strategies/budgets and as part of service redesign arising from the MTFS.</p>	<p>The Council is cognisant of its responsibilities to carry out Equality Impact Assessments and Island Communities Impact assessments, in particular around the budget setting process if there are cuts in services proposed which are likely to have an effect on an island community which is significantly different from its effect on other communities.</p> <p>Responsible officers: Corporate Directors for service redesign and Head of Finance for the budget report.</p> <p>Due Date: 30 June 2024</p>

5	<p>2 The Council recognises that overuse of strategic reserve fund is not sustainable as part of the longer term financial plans and strategy.</p> <p>There is a risk of financial imbalance and depleted reserves.</p> <p>Recommendation:</p> <p>We recommend that the Council should carry out detailed analysis to develop a strategy in relation to sustainable use of the strategic reserve fund taking into account the long-term commitments/plans of the Council which are expected to be settled/implemented through the use of the fund balance. It should determine a floor with a clear rationale and a policy/process for the approval of use of the fund.</p>	<p>The Council is aware that over reliance on the Strategic Reserve Fund is not a sustainable long-term strategy, however it is possible to take a regular contribution in line with the Investment Strategy for the Fund. The Policy and Resources Committee meeting of 19 December 2022 considered the contribution for 2023/24 and endorsed the long-term 10-year budget forecast as a financial planning document. An Investment Strategy Review of the Fund was carried out by Hymans Robertson in May 2021</p> <p>Responsible officers: Head of Finance</p> <p>Due Date: March 2025</p>
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Recommendations raised (Wider scope and Best Value)

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
6	③	<p>The policy requires the review and maintenance of risk registers (corporate and directorate). Corporate risk registers were presented to the Policy and Resources Committee periodically however directorate risk registers were last presented in June 2021. Additionally the internal audit report on corporate governance and risk management, dated 26th January 2023, identified action points for improvement.</p> <p>There is a risk of ineffective risk management.</p> <p>Recommendation: We recommend that risk management strategy should be implemented without exception.</p>	<p>As identified in the Council Plan, which was presented at Policy and Resources Committee on 21 February 2023, the Council has already committed to developing Directorate Risk Registers. These risk registers are being developed to support the Directorate Delivery Plans. The development of these plans and registers is in progress with one having already been presented at the Development and Infrastructure Committee on 14 November 2023 and another being presented at Policy and Resources Committee on 30 November 2023. The remaining will be presented to the relevant committees before 31 March 2024. The directorate risk registers will be regularly reviewed and updated in line with the Directorate Delivery Plan reporting. This action was further considered and agreed at Monitoring and Audit Committee on 8 June 2023 as part of the Local Code of Corporate Governance Improvement Plan and in the referenced 'corporate governance and risk management' audit report which was presented at Monitoring and Audit Committee on 9 February 2023. Several improvement actions from the 'corporate governance and risk management' audit report, dated 26 January 2023, have been completed. All these improvement actions will be closed out by 31 March 2025.</p> <p>Responsible officers: Responsibility for the Risk Management Framework: Head of Property, Asset Management & Facilities. Each Director is responsible for their own Directorate Risk Register.</p> <p>Due Date: March 2025</p>

Recommendations raised

Best

#	Risk	Issue, Impact and Recommendation	Management Response / Officer / Due Date
7	2	<p>The Council takes part in the LGBF performance reporting and reports clearly on those indicators aligned to the Council Plan.</p> <p>Recommendation:</p> <p>We recommend that a root cause analysis should be carried out to monitor the observed trend in performance, particularly in respect of those aligned to Council priorities but also the 'all other indicators', in order to support continuous improvement.</p>	<p>As highlighted in the Council Plan the Council is focusing on specific LGBF indicators that align with our priorities. These are the key indicators that we are focusing on over the terms of the plan. While the Council has identified these priority performance measures it will undertake further analysis and consideration of the other LGBF indicators to identify any areas for improvement when the most recent data is published. A full analysis of the latest data for 2022/2023 will be completed once it is published.</p> <p>Responsible Officer: Head of Improvement and Performance /</p> <p>Due date: 30 August 2024.</p>

Audit Differences

Under UK auditing standards (ISA (UK) 260) we are required to provide the Audit Committee with a summary of unadjusted audit differences (including disclosure misstatements) identified during the course of our audit, other than those which are 'clearly trivial', which are not reflected in the financial statements.

Unadjusted audit differences (£'000s)

Under UK auditing standards (ISA (UK) 260) we are required to provide the Audit and Risk Committee with a summary of adjusted audit differences (including disclosures) in excess of £250,000 identified during the course of our audit. The adjustments below have been included in the financial statements.

Adjusted audit differences (£'000s) – Financial Statements (Council and Group)

No	Detail	CIES Dr/(Cr)	Balance Sheet Dr/(Cr)	Comments
1	Dr Harbour Account Expenditure Cr Provisions	1,679 -	- (1,679)	- Being the understatement of the contractual provision for Flotta Oil Terminal this was due to an error in the formula in the calculation spreadsheet.
2	Dr Land and Buildings Gain on Revaluation of Land and Buildings	- (4,590)	4,590 -	Being the increase in the valuation of the Krkwall Office building following the change of valuation method to DRC from estimated Market Value.
3	Dr Net Pension Asset Cr Return on Assets	- (4,251)	4,251 -	Being the difference between the actual return on pension assets and the estimated return on assets outlined in the Actuary report.
4	Dr Investment in Associates, and Joint Ventures Cr Long Term Investments Dr Gain on Value of Investments	 2,152	2,374 (4,526)	Being the reclassification of Investments in Associates and Joint Ventures from Long Term Investments and reduction of Hammers Hill Limited valued at cost.
5	Dr Long Term Debtors Cr Long Term Investments	 	1,684 (1,684)	Being reclassification of the long terms loans outstanding at 31.3.2023
	Total	(5,010)	5,010	

Audit

Adjusted audit differences (£'000s) – Financial Statements (Council)

No	Detail	CIES Dr/(Cr)	Balance Sheet Dr/(Cr)	Comments
	Total b/f	(5,010)	5,010	
6	Dr Long Term Pension Asset	-	131,501	Being the reclassification of the LGPS pension Asset as a long term asset rather than a negative long term liability. This has been updated in the final statements.
	Cr Long Term Liabilities	-	(131,501)	
	Total	(5,010)	5,010	

Audit

Adjusted audit differences – Disclosures		
No		
1	Cashflow Disclosures	An amount of £10,343k was initially classified as Long Term Investments when it should have been disclosed as Short Term Investments - This has been updated in the revised statements
2	Remuneration Report Salary Tables	A small error was identified to the numbers of employees in the salary banding tables - This was updated In the revised statements
3	Related Parties Disclosure	A disclosure of a RPT debtor with Orkney Ferries Limited was updated from £91k to £987k. This was updated in the revised statements
4	Agency Services	The values disclosed in the initial draft for NDR Agency services was amended to the correct value of £10,528k n the revised statements
5	Loans Fund	The disclosures over the workings, the method and the legislation has been updated to reflect the current treatment
6	Property Valuations Disclosures	The disclosures around the sensitivity around the obsolescence rates used by the Council Valuer have been strengthened to aid the reader of the accounts
7	Expenditure and Income Analysed by Nature	The disclosures under this note were revised and aligned to the CIPFA code The disclosure was updated in the revised statements

We also identified a small number of non-significant disclosure adjustments, all of which were corrected by management.

Audit

Adjusted audit differences – Disclosures

No		
8	Note 22 The initial statements had an incorrect balance for the Employee Statutory Adjustment Account	The disclosure was updated in the final version of the statements

We also identified a small number of non-significant disclosure adjustments, all of which were corrected by management.

Audit Differences

Unadjusted audit differences (£'000s)

No	Detail	CIES Dr/(Cr)	Balance Sheet Dr/(Cr)	Comments
1	Cr Pension Assets	-	(345)	Being the actual pensions paid to pensioners v the estimated value of pensions paid included in the Actuaries report.
	Dr Pension Liabilities	-	345	
2	Cr Short Term Investments		(250)	Being the recognition of the impairment in Orkney Fisherman's Society which as per the Post Balance Sheet note has gone in receivership and this impairment would be needed to reflect the potential loss of investment by the Council
	Cr Short Term Debtors		(185)	
	Cr Short Term Loans		(130)	
	Impairment of Short Term Investments	565		
	Total	565	(565)	

Confirmation of Independence

We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Partner and audit staff is not impaired.

To the Audit Committee members

Assessment of our objectivity and independence as auditor of the Orkney Islands Council.

Professional ethical standards require us to provide to you with a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard.

As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

We are satisfied that our general procedures support our independence and objectivity.

Independence and objectivity considerations relating to the provision of non-audit services

Summary of non-audit services

Appendix four

We have not provided any non-audit services in year.



Confirmation of Independence (continued)

We have considered the fees charged to the Council for professional services provided during the reporting period. Total fees charged can be analysed as follows:

Entity	2022/23	2021/22
Auditor Remuneration**	£229,890	£133,730
Pooled Costs	£0	£13,940
PABV Contribution	£42,940	£44,920
Audit Support Costs	£7,900	£7,140
Sectoral Cap Adjustment	-£34,450	-
TOTAL AUDIT FEES (Incl VAT)	£246,280	£199,730
Fees for non-audit services	-	-

(** the average of tender values which may differ from what KPMG receives)

Source: Audit Scotland

Application of the FRC Ethical Standard 2019

We communicated to you previously the effect of the application of the FRC Ethical Standard 2019. That standard became effective for the first period commencing on or after 15 March 2020, except for the restrictions on non-audit and additional services that became effective immediately at that date, subject to grandfathering provisions.

We confirm that as at 15 March 2020 we were not providing any non-audit or additional services that required to be grandfathered.

Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the partner and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully



KPMG's Audit quality framework

Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion.

- To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework.
- Responsibility for quality starts at the top through our governance structures as the UK Board is supported by the Audit Oversight Committee, and accountability is reinforced through the complete chain of command in all our teams.

Commitment to continuous improvement

- Comprehensive effective monitoring processes
- Significant investment in technology to achieve consistency and enhance audits
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings

Association with the right entities

- Select clients within risk tolerance
- Manage audit responses to risk
- Robust client and engagement acceptance and continuance processes
- Client portfolio management



Clear standards & robust audit tools

- KPMG Audit and Risk Management Manuals
- Audit technology tools, templates and guidance
- KPMG Clara incorporating monitoring capabilities at engagement level
- Independence policies

Performance of effective & efficient audits

- Professional judgement and scepticism
- Direction, supervision and review
- Ongoing mentoring and on the job coaching, including the second line of defence model
- Critical assessment of audit evidence
- Appropriately supported and documented conclusions
- Insightful, open and honest two way communications

Commitment to technical excellence & quality service delivery

- Technical training and support
- Accreditation and licensing
- Access to specialist networks
- Consultation processes
- Business understanding and industry knowledge
- Capacity to deliver valued insights

Recruitment, development & assignment of appropriately qualified personnel

- Recruitment, promotion, retention
- Development of core competencies, skills and personal qualities
- Recognition and reward for quality work
- Capacity and resource management
- Assignment of team members employed KPMG specialists and specific team members

ISA (UK) 315 Revised: Overview

Summary

ISA (UK) 315 Identifying and assessing the risks of material misstatement incorporates significant changes from the previous version of the ISA.

These have been introduced to achieve a more rigorous risk identification and assessment process and thereby promote more specificity in the response to the identified risks. The revised ISA is effective for periods commencing on or after **15 December 2021**.

The revised standard expands on concepts in the existing standards but also introduces new risk assessment process requirements – the changes had a significant impact on our audit methodology and therefore audit approach.

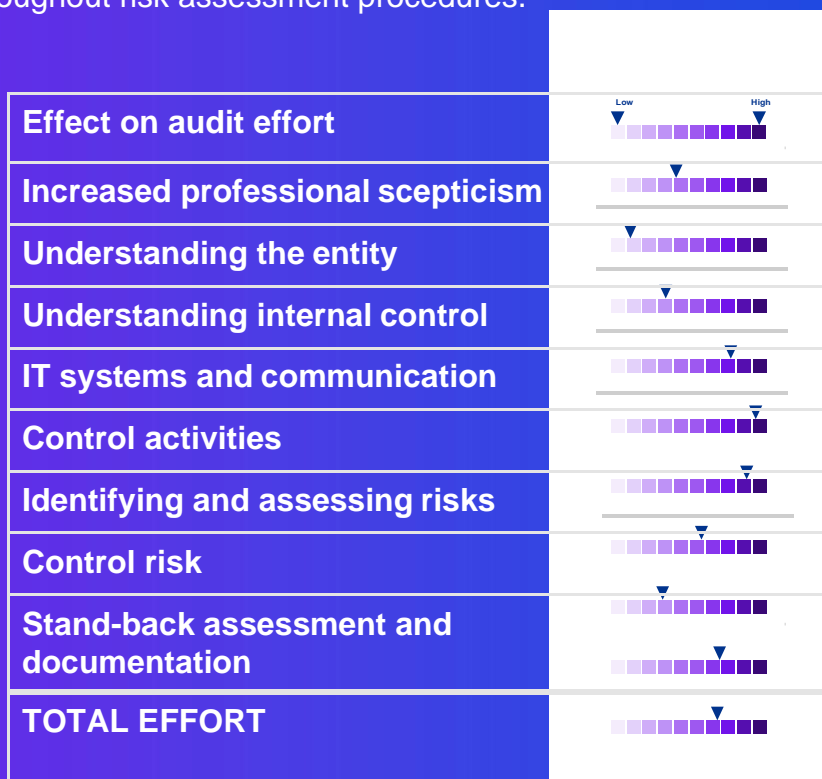
Why have these revisions been made?

With the changes in the environment, including financial reporting frameworks becoming more complex, technology being used to a greater extent and entities (and their governance structures) becoming more complicated, standard setters recognised that audits need to have a more robust and comprehensive risk identification and assessment mechanism.

The changes are aimed at (i) promoting consistency in effective risk identification and assessment, (ii) modernising the standard by increasing the focus on IT, (iii) enhancing the standard’s scalability through a principle based approach, and (iv) focusing auditor attention on exercising professional scepticism throughout risk assessment procedures.

What did this mean for our audit?

To meet the requirements of the new standard, auditors have been required to spend an increased amount of time across the risk assessment process, including more detailed consideration of the IT environment. These changes have resulted in significantly increased audit effort levels which in turn, has affected auditor remuneration. This additional effort is a combination of time necessary to perform the enhanced risk assessment procedures in our audits.






ISA (UK) 240 Revised: Summary of key changes

Summary and background

- ISA (UK) 240 The auditor's responsibilities relating to fraud in an audit of financial statements includes revisions introduced to clarify the auditor's obligations with respect to fraud and enhance the quality of audit work performed in this area. The revised ISA (UK) is effective for periods commencing on or after **15 December 2021**. Unlike ISA (UK) 315 which mirrors updates in the international ISA, the updated UK fraud standard is not based on international changes by the IAASB.
- The impact of the revisions to ISA (UK) 240 is less extensive compared to ISA (UK) 315, but nevertheless resulted in changes to our audit approach. The table to the right summarises the main changes and our final assessment of their impact.

What did this mean for our audit?

- The changes introduced new requirements which increased audit effort and therefore the audit fee. The additional work is largely the result of investing more time identifying and assessing the risk of fraud during risk assessment and involving specialists to aid with both risk identification and the auditor's response to risk.

Area	Effect on audit effort	Summary of changes and impact
Risk assessment procedures and related activities		<ol style="list-style-type: none"> Increased focus on applying professional scepticism – the key areas affected are: <ul style="list-style-type: none"> the need for auditors not to bias their approach towards obtaining evidence that is corroborative in nature or excluding contradictory evidence, remaining alert for indications of inauthenticity in documents and records, and investigating inconsistent or implausible responses to inquiries performed. Our inquiries with individuals at the entity were expanded to include, amongst others, those who deal with allegations of fraud We determined whether to involve technical specialists (including forensics) to aid in identifying and responding to risks of material misstatement due to fraud.
Internal discussions and challenge		We complied with enhanced requirements for internal discussions among the audit team to identify and assess the risk of fraud in the audit, including a requirement to determine the need for additional meetings to consider the findings from earlier stages of the audit and their impact on our assessment of the risk of fraud.
Communications with management / TCWG		We have complied with new requirements for communicating matters related to fraud with management and those charged with governance, in addition to the reporting in our audit reports.



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